South Jersey Gas

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VIA OVERNIGHT DELIVERY
March 20, 2003

Ms. Kristi Izzo
Board Secretary
State of New Jersey
Board of Public Utilities
Two Gateway Center
Newark, New Jersey 07102

Re: Audit of the Competitive Service Offerings of South Jersey Gas Company
Docket No. GA02020101

Dear Ms. Izzo:

As requested by Board staff, we are providing you with our comments on the FINAL Audit of Competitive Services Offerings ("Audit" or "Report") of South Jersey Gas Company ("SJG" or "the Company"). We are providing you with an original and ten copies for filing with the Board and for inclusion in the FINAL REPORT.

## MAJOR ISSUES

## MILLENNIUM ACCOUNT SERVICES, LLC

SJI disagrees with Overland's and Staff's opinion that Millennium is a Related Competitive Business Segment (RCBS) of a gas public utility holding company. SJI views this as an extremely serious issue. Attached, as Exhibit A, is a letter from Cozen O'Connor, Attorneys providing a legal opinion on our position regarding Millennium. As detailed in the opinion letter, we believe that (1) Millennium is not a RCBS, (2) the Board has never determined that meter reading is a competitive service, and (3) the Board lacks jurisdiction to establish prices for Millennium. Obviously, SJG believes that the Board has the jurisdiction to examine the reasonableness of SJG's meter reading expenses in a rate proceeding and that the appropriate standard is "fair market value."

Accordingly, there have been no violations of the Affiliate Standards related to Millennium and the appropriate standard of review for SJG's meter reading expenses in a rate case is "fair market value." As such, all findings, conclusions and recommendations that are based on the erroneous classification of Millennium as a RCBS are incorrect and should be disregarded.

## APPLIANCE SERVICE BUSINESS SPIN-OFF

SJG filed a petition with Board to spin-off the Appliance Service Business (ASB) in August of 2002. The majority of the issues that Overland raises with the ASB would be resolved through Board approval of the spin-off. We believe that Overland should have concluded that separating the ASB from the gas utility is an appropriate step and would advance the Board's deregulation policy and eliminate any issues with the Affiliate Standards.

Specifically, the Audit references the petition for approval to spin-off the Appliance Service Business (ASB) in several instances in Sections II and III of Chapter 4. Section IV of the same chapter directly addresses this topic. In summary, South Jersey believes that each of the concerns would be alleviated with Board approval of the August, 2002 Petition. Of course, South Jersey stands ready to negotiate a settlement of the matter as is noted throughout these comments.

## GENERAL PROBLEMS WITH COST ALLOCATIONS AND ACCOUNTING SYSTEMS

Overland summarizes its issues with South Jersey's accounting system at page 1-4. We will, however, address certain overriding issues in summary form in this section

Throughout the report, Overland criticizes South Jersey's three-factor cost allocation methodology and voices concerns as to the "bottom-up" allocation approach. We note that SJI's three-factor approach utilized factors identified in the last auditor's report in addition to being derived from the State of New Jersey's tax law [N.J.A.C. 18:7-8.3] which prescribes assets (property), payroll and receipts as their application factors. Management does not believe that receipts (sales) are proper when mixing retail operations with a wholesale operation (SJRG). Therefore, a common denominator (margin) was substituted. In short, South Jersey's three-factor approach, which is unacceptable to Overland, is derived from New Jersey tax law.

Throughout the report Overland addresses problems with South Jersey's accounting detail. At page 1-4 (B. Chapter 3.1). Overland states: "All of these factors hindered Overland's ability to review the cost allocation process employed by SJI and, more importantly, to quantify any misallocations of costs."

As was noted throughout the audit, SJG is currently in the process of implementing a new accounting system. As part of this process, we will strive to capture additional data and look for ways to improve allocations if warranted. While this changes nothing during the

audit period, South Jersey believes the implementation of the new accounting system should mitigate any related legitimate concerns raised during the audit.

## COMMENTS ON RECOMMENDATIONS

## V. Audit Recommendations

### A. Affiliate Transactions Documentation and Internal Control

1. Create separate inter-company payable and receivable accounts for each SJI subsidiary and joint venture and record all inter-company transactions in these accounts [Finding 2-II-

**RESPONSE: The Company agrees with the recommendation.**

2. Develop a single monthly inter-company invoice summarizing all changes from one affiliate to another. [Finding 2-II-Al.

**RESPONSE: The Company agrees with the recommendation.**

3. Since the same person currently holds both positions, delineate the job responsibilities of the Assistant Vice President - Gas Supply & Off-System Sales of SJG and Vice President of SJRG in writing. Document how potential conflicts of interest in these positions will be avoided when the two companies transact business with each other. [Finding 2-II-BI.

**RESPONSE: The Company agrees with the recommendation.**

4. Adjust the officer appointments and/or board memberships of SJG Millennium and other subsidiaries to comply with Affiliate Standards or obtain permission for variances from the BPU [Finding 2-11-C and 5-II-Cl.

**RESPONSE: The Company disagrees with the recommendation as SJI believes that Millennium is not a RCBS and the Affiliate Standards do not apply. In fact, SJI believes that the recommendation and its associated findings and conclusions which are discussed five (5) times in the Audit should be disregarded. See discussion in Major Issues section.**

5. Resubmit the SJG Compliance Plan after incorporating the findings and conclusions of this report and file on an annual basis thereafter. Summarize the changes in the Compliance Plan at the beginning of the document for ease of comparison.

**RESPONSE: The Company agrees with the recommendation.**

### B. Cost Allocations

1. Adopt an attributable cost basis for allocating the common costs of SJI departments and SJG departments providing shared utility services. Retain supporting workpapers for these allocations [Findings 2-II-A, 3-II-A, 3-II-B, 3-II-C 3-II-D 3-11-El

**RESPONSE: The Company agrees in principle with the recommendation. We agree that all supporting work papers for allocations should be retained and will address this issue with all appropriate personnel.**

**As for cost allocation practices, SJI and affiliates believe that our methods are reasonable. In fact, most, if not all, allocations are contained in the Cost Allocation Manual which addressed each cost factor on an individual basis. As stated on page 1 – 13 of the audit report (Section B.1. third bulleted item), "Likewise, costs incurred by each department should be tracked and allocated to each affiliate and/or RCBS *based on cost causation*. To the extent that SJI has *identified specific costs in its CAM, many of these costs appear to be assigned on this basis*." (emphasis added)**

**Further, SJI's three-factor approach utilized factors identified in the last auditor's report in addition to being derived from the State of N.J.'s tax law N.J.A.C. 18:7-8.3 which prescribes assets (property), payroll and receipts.**

**SJG is currently in the process of implementing a new accounting system. As part of this process, we will strive to capture additional data and develop methodologies which will improve allocations if warranted.**

2. Make necessary adjustments to all cost allocations affected by the organizational misalignment of shared corporate services [Finding 3-II-B1.

**RESPONSE: The Company agrees to demonstrate through its cost allocation procedures that the shared corporate services' unallocated costs are allocated to affiliates in proportion to the costs directly assigned or allocated on an attributable basis.**

**Management believes that there is no organizational misalignment of shared corporate services and that our current practice is fair. Based on the relative size of SJG in comparison to all other affiliates, SJG should bare a greater proportion of the shared corporate services as SJG would need each of these functions individually if completely separated from all non-utility affiliates. On the other hand, the non-utility affiliates have much less dependence on such functions and would likely not increase staffing to accommodate their needs if such sharing were not permitted.**

**Additionally, it should be noted that SJI / SJG's use of a fully allocated benefit rate on top of an individual's hourly rate of compensation fully considers the cost of vacations, holidays, sick time, etc. as detailed in SJI's CAM, B.3 – Benefits & Payroll Tax Allocation.**

**C. South Jerseys Gas Company Appliance Service Business**

1. Track assets and costs as specifically identified in the Affiliate Standards for all affiliates and related competitive business segments K-II-AI.

**RESPONSE: The Company agrees to track ASB assets and costs as a part of the accounting for the new ASB. SJG has complied with the applicable standards to the best of its knowledge. In addition, there is little benefit at this point to restructure the ASB accounting within the utility records. Management's intent is to dedicate its efforts on the separate ASB accounting system and improve upon record keeping methods as, and if, individual deficiencies are identified.**

2. Prohibit appliance service technicians from performing utility work and prohibit utility technicians from performing appliance repair service except in cases of emergency f4-11-D1.

**RESPONSE: SJG disagrees with this recommendation. We believe that the advantages to the utility from allowing the workforce to do both utility and ASB work outweigh any potential competitive advantages to the ASB. This position is set forth in detail in South Jersey's Petition for Authorization to transfer the ASB to a separate company. If SJG is not permitted to fully utilize its workforce, SJG may be forced to reduce full-time union utility jobs because of the lack of year around work.**

**It is true that the ASB and the utility utilize the expertise and training of each other's resources on an as-needed and as-available basis, although the amount of time spent working across businesses has been steadily decreasing. There are advantages to the utility of having a contingent workforce available on an as-needed basis to satisfy the needs of customers other than for emergencies. The ability to "peak shave" utilizing the ASB workforce allows the utility to handle situations such as "turn on" season seamlessly.**

**The utility also benefits from allowing its workforce to assist the ASB on an as-available basis. This flexibility allows the utility to maximize the productivity of its workforce and reduces utility costs.**

**It should also be noted that other New Jersey LDC technicians continue to do utility and appliance work. Given the relatively complex nature of this issue, and the potential cost saving benefits to the utility, South Jersey believes it should be deferred to the negotiations in settlement of the Petition. In this way a complete analysis can take place rather than merely citing the Affiliate Standards without reviewing the facts.**

3. Prohibit the ASB from using the utility's database from future targeted marketing (Finding 4-l i-Fl.

**RESPONSE: The Company agrees to the recommendation with modification as discussed below. At Chapter 4 Section II. F, Overland suggests the Appliance Service Business ("ASB") utilization of the utility database is "at variance with the Affiliate Standards restrictions on sharing customer data." Further, at recommendation C-3, Overland proposes: "Prohibit the ASB from using the utility's database from future targeted marketing (Finding 4-11-F)."**

**As to Overland's finding that the Company's practice is "at variance with the Affiliate Standards," South Jersey disagrees. This practice was established based upon a review of EDECA and the Affiliates Standards as follows:**

**EDECA at Section 36 (5) b. (2) states in part . . . An electric power supplier, a gas supplier, a gas public utility or an electric public utility *may use individual proprietary information that is obtained by virtue of its provision of electric generation service, electric related service, gas supply service or gas related service to: (a) initiate, render, bill and collect for such services . . . .*" The Act further defines "gas related service" as follows: "a service that is directly related to the consumption of gas by an end user, including, but not limited to the installation of demand side management measures at the end user's premises, *the maintenance, repair or replacement of appliances* or other energy-consuming devices at the end user's premises, and the provision of energy consumption measurement and billing services."**

**Clearly, this reading of EDECA ties the right to utilize customer information to gas related services which the ASB performs and which includes maintenance and repair services.**

**The Affiliate Standards at Section 6-3 (e) (1) (2) makes no reference to the sharing of customer information with a related competitive business segment of the public utility. The Standards do prohibit such sharing with related competitive business segments of the holding company. South Jersey believes this distinction is logical based upon the fact that, as in this case, the ASB is part of South Jersey Gas Company. We believe, however, that the ASB will lose its right to the utility database when the Board approves the spin-off Petition.**

**As such, if the recommendation were amended to read; "At a minimum, the ASB should be prohibited from carrying on this action after the Petition to Transfer is approved." South Jersey would agree with this recommendation.**

## D. Millennium Account Services LLC

1. Modify the agreement between Millennium and SJG to price meter reading services to recover no more than Millennium's fully allocated costs, including a regulated return on SJI's investment [Finding 5-II-FI.

**Response : The Company disagrees with the recommendation and in fact, believes that since Millennium is not a RCBS, this recommendation and its associated findings and conclusions should not be considered by the Board. In making this recommendation, the consultant has relied upon flawed assumptions and misinterpretations of the governing law. The following summarizes the Company's position on critical underlying principles as set-out in Exhibit A.**

- **Under traditional ratemaking principles, the Board lacks jurisdiction to establish prices for Millennium**

- **Nothing in EDECA confers upon the Board jurisdiction to regulate the rates of Millennium**
- **The Board has never determined that meter reading is a competitive service**
- **Even if meter reading were found to be a competitive service within SJG's service territory, Millennium need not file a tariff with the Board**

**Overland's calculation of "cross subsidization" is based upon its belief that Millennium, a non-regulated RCBS of the public utility holding company, should be limited to a return equivalent to that of the regulated utility. Even if the Board has jurisdiction over Millennium's rates which is clearly not the case, Overland's proposed imposition of a rate base, rate of return mechanism to a non-capital intensive enterprise is inexplicable (see Exhibit A). Further, the statement that even this unsubstantiated and extreme calculation of cross-subsidization "exceeded the savings realized by SJG" is wrong. SJG has provided data which indicates that contracting with Millennium has produced real, documented savings to the ratepayer of approximately $1,565,000 for the three year period ending on 12/31/01. Moreover, the cost per meter read borne by SJG was further reduced by a significant increase in the read rates from 85% pre-Millennium, to a current efficiency of 94% - an important part of the value equation seemingly lost or disregarded in the performed analysis.**

**The prices charged by Millennium to SJG should NOT be subject to review by the BPU since the Board's authority and jurisdiction does not extend to Millennium. However, The Board clearly has the authority and in fact the responsibility, to examine the prudency of meter reading expense incurred by SJG and the forum to do so is firmly established as a base rate case (see Exhibit A). Moreover, it is and will be first incumbent upon SJG to show the benefit to ratepayers derived from using an outside vendor source in lieu of its own employees. Further, both vendor choice and the prudency of price paid for services provided, should be subject to a contemporary market test as a standard of reasonableness that is clearly objective and measurable.**

**An apparent preconception that, moving internal functions to unregulated entities is inherently wrong appears to be at work as evidenced in footnote 10. We would argue that the utility's goal should always be the provision of needed service at the best value to ratepayers. EDECA and related regulations are by design and intent, aimed at creating fair competition which creates cost savings to ratepayers. If greater ratepayer value is realized through the use of unregulated contractors such as Millennium, has not the intent of the Act been advanced ?**

2. Delete provisions in the Meter Reading Services Agreement dated December 1, 2001 between SJG and Millennium which permit Millennium to compel SJG to take ownership of certain meter reading equipment [Finding 5-11-GI.

**Response: The Company disagrees with the recommendation. Negotiation of the current contract between Millennium and SJG was at arms-length. It must be noted that SJG no longer has meter reading equipment of its own and that Millennium's equipment upgrade was at SJG's request to enable remote meter reads. Assuming Millennium's continued performance under the terms of the contract and SJG's**

**exclusive ability to rely upon that contact through its term, a need for this provision would be reduced. However, should the decision to continue the relationship with Millennium be set-aside by Board order, this would leave SJG with no reasonable means to read its meters for a time, until an alternate third-party vendor was identified or the service was brought-back into the utility. In either case, SJG would want to have immediate access to necessary equipment so that degradation to customers service would be minimized through any transition. Millennium's profitability or ability to pay-off its investment is of no consequence to SJG. We would however, expect any vendor subject to an early "not for cause" contract termination provision, to reflect that real prospect in their pricing. In the case of Millennium, that risk could have been reflected in the price per read (as accelerated equipment depreciation costs impacted pricing) or in what amounts to a liquidating damages provision. The later was chosen by SJG given our need to secure the underlying meter reading equipment to fulfill our obligation to customers.**

E South Jersey Energy Company

1. Prohibit any direct or indirect compensation of SJG employees for marketing, selling, or promoting SJE products and services (Finding 6-II-A and 6-II-CI.

**RESPONSE: The Company agrees with the recommendation. SJG disagrees with the assertion that its past occurrences were violations of the Affiliate Standards. However, we note that if the Board approves the Petition to Transfer the ASB, a major portion of the issue would be alleviated. As to non-ASB employees performing such services, South Jersey would agree to stop such practices in the future. This agreement should not be construed to be an agreement that this practice is a violation of Affiliate Standards.**

**South Jersey notes that payments to SJG non-ASB employees were predicated upon work done during non-business hours. Simply stated, they did the work on their own time.**

**As to ASB employees, South Jersey believes that since an ASB employee was at the customer location, providing a competitive service, this practice did not violate the Affiliate Standards. Since the ASB was not called to the location to perform a utility service, no unfair advantage was gained. The ability to promote an SJE product was derived out of a competitive situation.**

## OTHER ISSUES

In Chapter 6, II.C. and III.C.3., Overland suggests that a telemarketing script used by SJE does not adhere to the Affiliate Standards. SJI believes that the statement does comply with the Affiliate Standards. A clear distinction is made between the utility and SJE who is not the utility. However, SJI understands the concern and will remove the word “affiliated” from its telemarketing script.

In Chapter 6, III. B. 2., Overland notes that an officer maintained a title in a subsidiary of SJE during the audit period. When the Board accepted the SJG audit recommendations in 2002, SJI evaluated the active companies for officer relationships. SJ EnerTrade is in a winding up mode as SJE expects to cease using this entity. Richard Walker's position as Secretary, a purely ministerial function, was overlooked. As soon, as SJI discovered the situation, the officer was removed from the subsidiary.

If you have any questions, do not hesitate to contact me.

Sincerely,

David A. Kindlick

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Executive Vice President, CFO &
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March 19, 2003

**VIA FEDERAL EXPRESS**

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**Re: Audit of the Competitive Service Offerings of South Jersey Gas Company**
**Docket No. GA02020101**

Dear Messrs. Walker and Kindlick:

South Jersey Gas Company ("South Jersey") has provided this firm with a copies dated March 14, 2003 and marked "Redacted Version" and "Confidential Version" of the Audit of the Competitive Service Offerings of South Jersey Gas Company ("Audit") in the referenced matter. The Audit was submitted to the New Jersey Board of Public Utilities ("Board"), Division of Audits by Overland Consulting ("Overland") of Overland Park, Kansas. You have asked for our opinion concerning the propriety of certain recommendations and conclusions drawn in the Audit.

Specifically, you have asked us to examine the recommendations: (1) that Messrs. Albert V. Ruggiero, Executive Vice President and Chief Administrative Officer, South Jersey and Mr. Richard H. Walker, Corporate Secretary and General Counsel, South Jersey, be prohibited from serving on the Executive Committee of the Board of Managers of Millennium Account Services, L.L.C. ("Millennium") (the "Executive Committee Recommendation"); and (2) that in the future, the Board should: (i) regulate Millennium's prices to South Jersey; and (ii) establish prices in a manner such that Millennium may recover only its fully allocated costs, including a regulated return on Millennium's assets (the "Pricing Recommendation").

In this firm's opinion, the Board has no jurisdiction to implement the Pricing Recommendation. Moreover, it would be unlawful for the Board to implement the Executive Committee Recommendation at this time.

In this letter, we will first address the Pricing Recommendation.

## I. BACKGROUND

As we understand it, Millennium was established in 1999 as a Delaware limited liability company. Millennium is owned fifty percent (50%) by South Jersey Industries, Inc. ("SJI"), a public utility holding company which owns one hundred percent (100%) of the common stock of South Jersey. An additional fifty percent (50%) of Millennium is owned by Conectiv Solutions, Inc. Conectiv Solutions, Inc. is an affiliate of Atlantic City Electric Company ("ACE"), a public utility regulated by the Board.

Millennium was formed to market wholesale meter reading services to investor-owned and governmental public utilities, within and without southern New Jersey. While numerous marketing efforts have been made by Millennium, to date only ACE and South Jersey are actual customers. Millennium was formed because it was felt that if multiple public utilities outsourced the meter reading function to a single entity efficiencies could be achieved, resulting in a meter reading cost which would be lower in the aggregate to South Jersey and ACE, and other public utilities, than was the case when they provided meter reading services directly. Millennium charges South Jersey and ACE a specified charge for each meter read by Millennium. South Jersey and ACE have achieved savings through the use of Millennium.

Millennium is engaged in no business, other than the wholesale sale of the meter reading service. Millennium periodically invoices both South Jersey and ACE for meters read, and South Jersey and ACE pay these invoices. The end-users of the meter reading business are, of course, the residential, commercial and industrial customers of ACE and South Jersey. These customers purchase this service from South Jersey and ACE at retail, as part of a bundled utility bill. South Jersey and ACE resell the service which they purchase at wholesale from Millennium. Meter reading services are not offered to end user customers in New Jersey on a competitive basis today. However, at some point, the Board may order that end-user customers may elect to take meter reading services from third-party suppliers, and make the retail supplying of meter reading services competitive.

## II. UNDER TRADITIONAL RATEMAKING PRINCIPLES, THE BOARD LACKS JURISDICTION TO ESTABLISH PRICES FOR MILLENNIUM

The Board's traditional ratemaking jurisdiction is found in N.J.S.A. 48:2-21, which has been amended from time to time over the years, but was originally enacted in 1911. That statute provides, in part, that:

> The board may require ***every public utility*** to file with it complete schedules of every classification employed and of every individual or joint rate, toll, fare or charge made, charged or exacted by it for any product supplied or service rendered within this State … (Emphasis added).

The statute then goes on to provide procedures for the establishment and alteration of public utility rates. This statute, however, applies only to an entity defined as a "public utility."

A public utility is defined in N.J.S.A. 48:2-13. The definition is as follows:

> The term "public utility" shall include every … corporation … that now or hereafter may own, operate, manage or control within this State any railroad, street railway, traction railway, autobus, charter bus operation, special bus operation, canal, express, subway, pipeline, gas, electric light, heat, power, water, oil, sewer, solid waste collection, solid waste disposal, telephone or telegraph system, plant or equipment for public use, under privileges granted or hereafter to be granted by this State or by any political subdivision thereof.

In order to be a "public utility" a corporation must own, operate, manage or control certain facilities, which may be termed "Jurisdictional Facilities." These Jurisdictional Facilities include, *inter alia*, gas, electric light, power, water or sewer plant or equipment. Millennium owns, operates, manages, or controls no Jurisdictional Facilities, and therefore is not a "public utility". As a result, under the long-established laws of this State, Millennium is not subject to rate regulation by the Board.

## III. NOTHING IN EDECA CONFERS UPON THE BOARD JURISDICTION TO REGULATE THE RATES OF MILLENNIUM.

After we determined that under traditional legal principles, the Board did not have jurisdiction to regulate the rates of Millennium, we next examined a recent legislative enactment which might have a bearing on this issue. Effective February 9, 1999, the Legislature of the State of New Jersey enacted the "Electric Discount and Energy Competition Act" ("EDECA"). EDECA is codified at N.J.S.A. 48:3-49, *et seq.*

There is nothing in EDECA that would cause us to change our conclusion that the Board does not have jurisdiction to establish rates to be charged by Millennium.

**Contrary to the Assertions of Overland, Millennium Is Not Engaged in Providing Services to Retail Customers. Its Operations Are, Therefore, Not Subject to Pricing Regulations under EDECA.**

Pursuant to EDECA, the Board has adopted the "Affiliate Relations, Fair Competition and Accounting Standards and Related Reporting Requirement" ("Affiliate Standards") (N.J.A.C. 14:4-5.1, *et seq.*). The Affiliate Standards contain pricing provisions applicable to certain affiliates of public utilities. These pricing provisions are contained within N.J.A.C. 14:4-5.3 through N.J.A.C. 14:4-5.5.

However, N.J.A.C. 14:4-5.1(a)1. clarifies that the pricing provisions, and other standards of conduct contained within N.J.A.C. 14:4-5.3 through N.J.A.C. 14:4-5.5 are only applicable to an affiliate of a public utility, which affiliate is "providing or offering competitive services ***to retail customers*** in New Jersey." (Emphasis added).

Overland concludes that the provisions of the Affiliate Standards applicable to transactions between a public utility and its affiliate are applicable to Millennium because Millennium offers competitive services to retail customers. Overland contends that South Jersey and ACE do not resell the meter reading service to their customers. As Overland states "neither of these two customers re-sells the meter reading services provided by

Millennium to their own customers." (Audit [Redacted Version], P. 5-1). Overland is simply incorrect in its application of the Affiliate Standards.

Millennium has no contractual relationship whatsoever with the residential, commercial and industrial customers whose meters it reads. In fact, Millennium has no day-to-day contact with these public utility customers, whatsoever. Millennium contracts to provide wholesale service to ACE and South Jersey. ACE and South Jersey, in turn, invoice their customers for, and resell the meter reading service as part of a bundled utility bill. The only payments flowing to Millennium flow from South Jersey and ACE. South Jersey and ACE buy "bulk" meter reading services from Millennium; disaggregate these bulk services into smaller pieces; and sell those smaller pieces to individual customers. In short, Millennium is a wholesale rather than retail provider of meter reading services.

The Affiliate Standards contain no definition of "retail". However, Webster's New Collegiate Dictionary provides a definition for the noun "retail" as follows: "the sale of commodities or goods in small quantities to ultimate consumers." Webster's New Collegiate Dictionary (1976). That same dictionary goes on to provide that the adjective "retail" means "of, relating to, or engaged in the sale of commodities at retail." Id.

The ultimate consumers of meter reading services are the customers of South Jersey and ACE. Millennium does not sell a service to these ultimate consumers, and, applying a pure dictionary definition demonstrates that Millennium is not involved in a retail business. New Jersey statutory and case law supports the dictionary interpretation of "retail."

"Retail sales" under relevant New Jersey statutory provisions are sales of products or services other than for resale. N.J.S.A. 54:32B-2(e). See also, Fairlawn Shopper, Inc. v. Director, Division of Taxation, 98 N.J. 64, 71 (1986); GNOC, Corp. v. Director, Division of Taxation, 167 N.J. 62, 63 (2001).

Since Overland's conclusions relative to the Pricing Recommendation are premised upon an incorrect conclusion that Millennium is engaged in retail sales, its recommendation should be disregarded.

**The Board Has Never Determined That Meter Reading Is a Competitive Service.**

Pursuant to EDECA, meter reading will not be a competitive service, until such time as the Board determines that it is a competitive service.

Overland asserts that the Board's Staff "has determined that the meter reading function falls within the definition of a competitive service." Audit (Redacted Version) at P. 5-1. We are not advised how or when this was done. However, only the Board has jurisdiction to make such a decision, and only after appropriate procedures. Pursuant to N.J.S.A. 48:3-51, a competitive service is defined to mean "any service offered by … a gas public utility that the board determines to be competitive pursuant to … section 10 of this act or that is not regulated by the board." Meter reading is clearly a service regulated by the Board.

Pursuant to N.J.A.C. 14:3-3 through 14:3-4, the Board regulates meter reading and related activities. For example, pursuant to N.J.A.C. 14:3-3.8, the Board grants public utilities the right of reasonable access to, among other things, read meters. Other aspects of

meter related activities regulated by the Board include: ownership (N.J.A.C. 14:3-4.1); meter testing (N.J.A.C. 14:3-4.4-5); meter test reports and records (N.J.A.C. 14:3-4.8, 9) and equipment testing (N.J.A.C. 14:3-4.4). Because meter reading and related activities are regulated by the Board, meter reading will not be a competitive service unless and until the Board so determines.

The mechanism pursuant to which the Board may make a determination that a service is a competitive service is found in N.J.S.A. 48:3-58h. That section provides that the Board is authorized to determine, after notice and hearing, whether any service offered by a gas public utility is a competitive service. In making such a determination, the statute provides, the Board must develop standards of competitive service which at a minimum, shall include: evidence of ease of market entry; presence of other competitors; and the availability of like or substitute services in the relevant geographic area. See N.J.S.A. 48:3-58h. After making appropriate findings on these and other elements, the Board may then determine whether or not a service is "competitive."

The Board has never conducted a proceeding in which it made findings relative to gas meter reading concerning the evidence of ease of market entry in South Jersey's service territory; the presence of other meter reading competitors within South Jersey's service territory; the availability of meter reading services within South Jersey's service territory; or other relevant factors.

Should the Board undertake to determine whether meter reading services were a "competitive service" within South Jersey's service territory, it would have to do so in compliance with the "contested case" provisions of the Administrative Procedure Act ("APA"), N.J.S.A. 52:14B-1, *et seq.* In particular, it would have to comply with N.J.S.A. 52:14B-9 of the APA, which would require particularized notice, opportunity to present evidence on all issues involved, and findings of fact based exclusively on the evidence and on matters officially noticed.

Moreover, the Board's findings cannot violate the express or implied language of EDECA or the APA; and must be reasonably based upon the substantial evidence of record. See, R&R Marketing, LLC v. Royal Distributors and Importers, Ltd., 158 N.J. 170, 175 (1999); Public Service Electric & Gas Co. v. State Dept. of Envt'l Protection, 101 N.J. 95, 103 (1987).

Alternatively, if the Board is to make a determination that meter reading is competitive on an industry-wide basis, State-wide, the Board would have to proceed through rulemaking. See, Metromedia, Inc. v. Director, Bd. of Taxation, 97 N.J. 313 (1984); Woodlands Private Study Group v. N.J. Dept. Envt'l Protection, 109 N.J. 62 (1987); Hampton v. Dept. of Corrections, 336 N.J. Super. 520 (2001); Bullet Hole, Inc. v. Dunbar, 335 N.J. Super. 562 (2000). In such an event, the Board would be required to follow the rulemaking provisions of N.J.S.A. 52:14B-4.

We have reviewed the series of Orders issued by the Board in the proceeding entitled In the Matter of the Electric Discount and Energy Competition Act of 1999 – Customer Account Services, Docket No. EX99090676. In none of those orders did the Board make the

appropriate findings, or conclude that meter reading was a competitive service either within South Jersey's service territory, or throughout the State of New Jersey.

We have likewise examined the Board's Orders in the proceeding entitled In the Matter of the Audits of the Competitive Services Offerings of New Jersey's Electric and Gas Utilities Pursuant to the Electric Discount and Energy Competition Act, Pursuant to N.J.S.A. 48:3-55, 48:3-56 and 48:3-58, Docket Nos.AA00040232, EA00040233, EA00040234, EA00040235, EA00040236, GA00040237, GA00040238 and GA00040239. In its Order in those docket numbers dated March 27, 2002, the Board accepted certain recommendations of a competitive services audit applicable to ACE. Those recommendations were as follows:

> V.B.6 The Board and ACE should consider reclassifying Millennium as an RCBS, fully subject to the Standards. (See V.A.1)
>
> V.B.7 Should the Board or ACE adopt the previous recommendation, ACE should update the compliance plan to reflect standards that apply to Millennium. (See V.A.2, V.A.4, V.A.6)

The adoption of a recommendation that the Board "should consider" reclassifying Millennium as a competitive business, certainly does not constitute a finding that Millennium is in a competitive line business. Moreover, even if the finding were made that Millennium is involved in a competitive business in a proceeding involving ACE, this determination would not be binding upon South Jersey. As to South Jersey, none of the aforementioned requirements of EDECA or of the APA were followed. Application of a "competitive services" definition as to South Jersey, if it had been made, would have been unlawful.

No such determination was made in conformity with the EDECA requirements, nor in conformity with the APA. Overland's belief that such a determination was made is incorrect, and should be disregarded.

Overland also states: "Similar services such as metering and billing are deemed competitive services by the BPU." [Audit (Redacted Version), at p. 5-1]. Overland relies upon the Affiliate Standards at N.J.A.C. 14:4-5.6(b)1.

It is there provided as follows:

> (b) [A] … gas public utility or its related competitive business segment may only offer to provide the following competitive products and/or services:
>
> 1. Metering, billing or administrative services ***that are deemed competitive by the Board pursuant to N.J.S.A. 48:3-56***; (emphasis added).

These provisions of the Affiliate Standards closely mirror similar statutory provisions. N.J.S.A. 48:3-58.b. provides as follows:

> b. Subject to the approval of the board pursuant to subsection d. of this section, a gas public utility or a related competitive business segment of that gas public utility may provide the following competitive services:
>
> (1) Metering, billing and related administrative services ***that are deemed competitive by the board pursuant to this section***; (emphasis added).

What these provisions make clear is that, contrary to the assertions of Overland, metering, billing and related administrative services are not deemed competitive, until the Board conducts a full proceeding, and determines that they are competitive in accordance with the procedures described in this letter. Overland's assertions that they are competitive misconstrue the Affiliate Standards, and the underlying statutory law.

The entire Pricing Recommendation is based upon the erroneous conclusion that Millennium's meter reading services have been found to be competitive. As a result, the Pricing Recommendation is deficient.

**Even If Meter Reading Is a Competitive Business within South Jersey's Service Territory, Millennium Need Not File a Tariff with the Board.**

As we have demonstrated, Millennium is neither a retail nor a competitive business. However, even if it were both, it would not be subject to even minimal price regulation under EDECA. EDECA provides for two kinds of business entities which are engaged in competitive businesses. Each of these is a Related Competitive Business Segment ("RCBS"). One type of RCBS is an RCBS of a gas public utility. Another type of RCBS is an RCBS of a gas public utility holding company. See N.J.S.A. 48:3-51. The following definitions are applicable:

> "Related competitive business segment of an electric public utility or gas public utility" means any business venture of an electric public utility or gas public utility including, but not limited to, functionally separate business units, joint ventures, and partnerships, that offers to provide or provides competitive services;
>
> "Related competitive business segment of a public utility holding company" means any business venture of a public utility holding company, including, but not limited to, functionally separate business units, joint ventures, and partnerships and subsidiaries that offers to provide or provides competitive services, but does not include any related competitive business segments of an electric public utility or gas public utility;

Since Millennium is structured as a partially-owned subsidiary of SJI, if it is either type of RCBS, it is an RCBS of a public utility holding company. Pursuant to EDECA, the Board has absolutely no jurisdiction to regulate the rates of an RCBS of a public utility holding company. This is distinguished from the limited jurisdiction which the Board has

over rates of an RCBS of a gas public utility. Pursuant to N.J.S.A. 48:3-58, an RCBS of a gas public utility may be required to file and maintain tariffs. Pursuant to those tariffs, the price charged may not be less than the fully allocated cost of providing the service, as determined by the Board.

The Board is not granted jurisdiction to establish rates for an RCBS of a gas public utility. It simply must ensure that the rates of an RCBS of a gas public utility are not too low. That is, the Board must impose a floor, but may not impose a ceiling, as Overland recommends for Millennium. See Re South Jersey Gas, BPU Docket No. GR99010022 (April 16, 1999) (stating that EDECA requires only setting a floor and not limit for rates for competitive services).

Moreover, even this limited jurisdiction to establish a floor for rates is not applicable to an RCBS of a gas public utility holding company, such as Millennium would be if it were engage in a competitive, retail business. Rather, the Board's jurisdiction is limited to an RCBS of a public utility.

The distinction between the two types of RCBS is quite logical. The purpose of the establishment of a floor for an RCBS of a gas public utility, is to ensure that ratepayers paying for the non-competitive, regulated services provided by the gas public utility do not subsidize the operations of the RCBS of the gas public utility. There is no such concern applicable to the RCBS of a gas public utility holding company, which as a functionally separate entity would not encounter such a problem.

This conclusion is further demonstrated by N.J.S.A. 48:3-58g. which provides that except for those statutory provisions related to the regulation of depreciation rates and tariff rates of ***public utilities***, a category in which Millennium clearly does not fall, the Board "shall not regulate, fix or prescribe the rates, tolls, charges, rate structures, rate base, or cost of service of competitive services." See also, Re South Jersey Gas, BPU Docket No. GR99010022 (April 16, 1999).

In short, the Board lacks jurisdiction to establish Millennium's rates either under traditional concepts of utility ratemaking, or under EDECA.

## IV. EVEN IF THE BOARD HAD JURISDICTION TO ESTABLISH MILLENNIUM'S RATES, APPLICATION OF RETURN ON INVESTED CAPITAL PRINCIPLES TO MILLENNIUM MAKES NO SENSE.

Overland not only proposes unlawfully subjecting Millennium to rate regulation, but, in addition, it proposes a methodology for such regulation. In essence, Overland proposes that the Board allow Millennium to recover its costs, including a profit determined by a regulated return on net assets. (Audit [Redacted Version], P. 5-9). Millennium is a "services business" and is not capital intensive. As a result, allowing a profit determined through a return on net assets would result in a meager authorization to Millennium.

Our Legislature has long recognized that establishing rates for a public utility based upon a return on net assets (roughly equivalent to "rate base") is not always appropriate. For example, N.J.S.A. 48:2-21.2.(b) provides that in determining the justness or reasonableness

of a rate, the Board need not find a rate base if it determines that the gross operating revenues of the public utility exceed the depreciated book cost of the public utility's property used and useful in its business as a public utility. This, of course, would be an example of a public utility which is less capital intensive, and has a relatively low level of net assets. In such instances, the Board recognizes, traditional rate base/rate of return regulation is inappropriate. See id. For the same reason, such an approach is inappropriate as to Millennium.

The United States Supreme Court has indicated that the controlling factor for determining a regulated return is its reasonableness in light of the "the financial soundness of the utility" and adequacy "under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." Bluefield Waterworks and Improvement Co. v. Pub. Service Comm. of West Virginia, 262 U.S. 679, 692-93 (1923). Millennium, if its return was to be regulated by the Board, must be permitted to earn a return comparable to "other enterprises having corresponding rights [and] sufficient to assure confidence in the financial integrity of the enterprise …". Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944). See also, Dequesne Light Co. v. Barasch, 488 U.S. 299 (1989); Permian Basin Area Rate Cases, 390 U.S. 747 (1968). In other words, it must be permitted to earn a return comparable to those earned by other, non-capital intensive business enterprises.

New Jersey, in applying the principles of Bluefield Waterworks and Hope Natural Gas has recognized that "participants in a regulated industry are entitled to something more than mere survival" when determining appropriate rates. State Farm Mutual Automobile Insurance Co. v. New Jersey, 124 N.J. 32, 47-8 (1991); see also, Hutton Park Gardens v. Town Council, 68 N.J. 543, 570 (1975) (a "return should be one which is generally commensurate with returns on investments in other enterprises having comparable risks." Id.).

In Duquesne Light Co., the Supreme Court further fleshed out the appropriate standard for setting a rate of return in any circumstance. The rate of return must be a "fair rate of return given the risks under a particular rate setting system…". 488 U.S. at 617. Considering that Millennium is personnel rather than capital intensive, and has a right to something more than "mere survival", its return can not be predicated upon regulated return on assets.

## V. THE BOARD DOES HAVE JURISDICTION TO EXAMINE THE REASONABLENESS OF SOUTH JERSEY'S METER READING EXPENSES IN THE CONTEXT OF A RATE CASE.

Our conclusions in this letter should not be understood to stand for the proposition that the Board exercises no regulatory oversight concerning charges made by Millennium to South Jersey. To the contrary, the Board need not, and indeed must not, simply allow South Jersey to pass through charges made by Millennium, without reviewing those charges for reasonableness.

In any rate proceeding, careful examination is made as to the reasonableness of charges made by an affiliate to the public utility. We would anticipate that such an investigation would occur in South Jersey's next base rate proceeding. There would not be an

examination of the books and accounts of Millennium. Rather, the inquiry would be into the reasonableness of the expenses to South Jersey. See, In re N.J. American Water Co., 169 N.J. 181, 188 (2001); In re: Pub. Service Electric & Gas, 304 N.J. Super. 247, 265 (1967). See also, State v. Public Service Coordinated Transport, 5 N.J. 196, 222 (1950).

Since the forming of Millennium in 1999, South Jersey has not had a base rate proceeding. Thus, the effects of Millennium have not been passed through to South Jersey's customers. From a regulatory standpoint there has been, and is no reason to inquire into the propriety of payments made by South Jersey to Millennium now. When South Jersey makes a claim for the recovery of such expenses, the Board may properly inquire into their reasonableness.

## VI. WHEN THE BOARD EXAMINES THE REASONABLENESS OF CHARGES MADE BY MILLENNIUM TO SOUTH JERSEY IN THE CONTEXT OF SOUTH JERSEY'S RATE CASE, THE STANDARD PROPOSED BY OVERLAND WILL BE INAPPLICABLE.

The Affiliate Standards contain provisions relevant to the pricing of services transferred from the RCBS of a public utility holding company to the gas public utility. Pursuant to N.J.A.C. 14:4-5.4(t)2. such transfers of services "produced, purchased or developed for sale on the open market" by the RCBS shall be priced at no more than fair market value. By contrast, pursuant to N.J.A.C. 14:4-5.5(t)6, transfers of such services not produced, purchased or developed for sale on the open market by the RCBS must be priced at the lower of fully allocated cost or fair market value. Overland erroneously concludes that the "lower of fully allocated cost or fair market value" is the appropriate standard.

In the first place, these sections are not applicable whatsoever. This is so because, as previously noted, Millennium is not a retail business. They further do not apply because the Board has never determined, in an appropriate proceeding, that meter reading is a "competitive" business within South Jersey's service territory. Finally, the standard advocated by Overland is not applicable because, while Millennium has not successfully marketed its meter reading services to entities other than South Jersey and ACE, its services have been both "produced" and "developed" for sale on the open market. While Millennium is a new company, and its sales solicitation efforts to date to entities other than South Jersey and ACE have been unsuccessful, it has nevertheless attempted to, and will continue to attempt to market these services to other entities.

In any event, as previously noted, these standards are not applicable. The Board, in South Jersey's rate case, will simply have to determine whether the costs incurred by South Jersey are reasonable. See, In re N.J. American Water Co., 169 N.J. 181, 188 (2001); In re: Pub. Service Electric & Gas, 304 N.J. Super. 247, 265 (1967). See also, State v. Public Service Coordinated Transport, 5 N.J. 196, 222 (1950).

## VII. MESSRS. RUGGIERO AND WALKER MAY CONTINUE TO SERVE AS OFFICERS OF SOUTH JERSEY AND MEMBERS OF THE BOARD OF DIRECTORS AND EXECUTIVE COMMITTEE THEREOF OF MILLENNIUM.

The Affiliate Standards prohibit a corporate officer of a public utility from serving on an Executive Committee of a Board of Managers (the equivalent of a board of directors) of a related competitive business segment of a public utility holding company if the RCSB is performing a competitive, retail service within the public utility service territory. See N.J.A.C. 14:4-5.1, 14:4-5.3 and 14:4-5.5(q). As noted above, N.J.A.C. 14:4-5.3 through 14:4-5.5 are only applicable to transactions between a public utility and related competitive business segments of its public utility holding company that provides competitive, retail services. Because meter reading is not yet designated a competitive service under EDECA, and because services are provided as wholesale services by Millennium, the prohibition on corporate officers of a public utility serving on the Board of Directors of a related competitive business segment of its public utility holding company, articulated at N.J.A.C. 14:4-5.5(q) is not applicable to Millennium. Only if meter reading is designated a competitive service and Millennium becomes a retail provider of such services, will Messrs. Ruggiero and Walker be prevented from serving on Millennium's Executive Committee and Board of Managers while remaining corporate officers of South Jersey.

Cordially yours,

COZEN O'CONNOR

Ira G. Megdal

By: Ira G. Megdal

IGM/vm